No. 3844

IN THE 9

United States
Circuit Court of Appeals
For the Ninth Circuit

In the matter of C. F. MASON and WM. McD. OWEN, co-partners, trading as MASON & OWEN,
Bankrupts

C. F. MASON and WM. McD. OWEN,
Bankrupts

GEORGE P. KIER, Trustee
Appellant

J. E. STEER, Appellee

BRIEF OF APPELLEE

Upon Appeal from the United States District Court, for the Southern District of California, Southern Division

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San Diego, California

WATSON-JONES, INC., PRINTERS, SAN DIEGO, CAL.

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C. F. MASON and WM. McD. OWEN,

Bankrupts,

GEORGE P. KIER, Trustee,

Appellant,

vs.

J. E. STEER, Appellee.

Brief of Appellee

FURTHER STATEMENT OF FACTS.

In addition to the facts set out by appellant we would add:

Steer purchased the 100 shares of Midvale from Mason & Owen on March 20th, 1920, and on that date paid them in full.

On November 20, 1920, prior to the filing of petition in bankruptcy, Steer demanded his stock from Mason & Owen and on November 24th, 1920, demanded it from Logan & Bryan who had held the stock from date of purchase (Record, page 4). All dividends on said stock were paid to Steer by Mason & Owen prior to bankruptcy but the dividend of Fifty Dollars received Jan. 1,

1921, after bankruptcy has not yet been paid to Steer (Record, page 5).

Petition in Bankruptcy was filed December 6th, 1920. Subsequently all stocks purchased from Mason & Owen on margin were sold by Logan & Bryan under order of court to satisfy the indebtedness of Mason & Owen to Logan & Bryan, the proceeds of said sale of marginal stock more than paid all of the Mason & Owen indebtedness to Logan & Bryan and the marginal stocks were the only ones sold by Logan & Bryan to liquidate their claim. (Record, page 7b). Twenty-one securities, including the 100 shares of Midvale, all fully paid for to Mason & Owen and with no trade pending thereon, were not sold but survived the liquidation. (Record, page 7b).

The 100 shares of Midvale at the time of Bankruptcy was the only Midvale stock held by Mason & Owen or Logan & Bryan for Mason & Owen, and no one other than Steer was "long" on Midvale on the books of Mason & Owen. No claim has been filed against Mason & Owen for Midvale Stock by any one other than Steer (Record, page 6).

All stocks in the hands of Logan & Bryan prior to the bankruptcy were held by them as pledged to secure the indebtedness of Mason & Owen to them. Among these they held this 100 shares of Midvale, so pledged, but without authority or consent from Steer and without his knowledge (Record, pages 3 and 4).

ARGUMENT.

This 100 shares of Midvale stock *is sufficiently identified*, since at the time of bankruptcy there was in the hands of Logan & Bryan to the credit of Mason & Owen

an equal amount of the same kind of stock and no one else claiming it.

Gorman vs. *Littlefield,* 229 U. S., 19, at 24-25;
Duel vs. *Hollins,* 241 U. S., 523, Syl.;
In re Wilson, 252 Fed., 636, at 651.

This is true no matter whether the stock is in the hands of a pledgee, Logan & Bryan, or in the "box" of Mason & Owen.

In re Wilson, 252 Fed., 639 at 654.

The same conclusion is reached in appellant's case, *Spokane County* vs. *First National Bank of Spokane,* 68 Fed., 979 at 983.

Bankruptcy courts have even gone so far as to hold "that where petitioner entrusted certain money to the bankrupt for safe keeping only, and he deposited it to the credit of his general bank account, which at all times exceeded the amount so intrusted to him and come into the hands of his trustees in bankruptcy, plaintiff was entitled to enforce a preferred claim on such bank balance in the hands of the trustee, tho the actual money delivered to the bankrupt could not be identified".

In re Royea, 143 Fed., 182, Syl.

The whole line of bankruptcy cases without exception from the oldest to the very most recent cases holds that "securities held by stock brokers as collateral to their customers' accounts may, where the latter are not indebted to the brokers, be recovered by such customers from the trustee in bankruptcy of the broker's estate."

Thomas vs. *Taggart,* 209 U. S., 385, Syl. 3.

The bankrupts can not avoid this result by claiming that they converted this particular stock, for the bankrupts are presumed to hold 100 shares of Midvale at all

times for claimant Steer and "no creditor could justly demand that the (*bankrupts'*) estate be augmented by a wrongful conversion of property of another in this manner or the application to the general estate of property which never rightfully belonged to the bankrupt."

Gorman vs. *Littlefield*, 229 U. S., 19, at 25.

In said *Gorman* vs. *Littlefield, supra*, the stock was bought on the order of the customer, fully paid for, left in the broker's possession, found in the hands of the trustees of the bankrupt broker, and was ordered by the court to be delivered to the customer, exactly the case at bar except that there was no intervening pledge to be considered.

But even tho pledged wrongfully or rightfully the stock *when paid for in full is the property of the purchaser*, and he is entitled to its possession. Courts have held that where a customer who had been trading with a broker but had certain stock fully paid for with no trade pending, demanded delivery of those stocks from the broker who was then insolvent and had pledged the stock to secure a loan; that when the broker redeemed that stock and delivered it to his customer it was not a preference and the customer was entitled to the stock.

Richardson vs. *Shaw*, 209 U. S., 365.

If the customer was entitled to the stock in the course of business, when insolvent, prior to bankruptcy, then logically all customers who have paid for their stock in full could demand the delivery of it, the insolvent broker would be required to redeem it and deliver to the customer, which would leave the marginal stocks in the hands of the broker with which to pay off the pledged indebtedness.

And this logic is supported by the decisions of the court authorizing that same transaction even after bankruptcy. Thus "a stockbroker who purchases and carries stocks on account of a customer on margins furnished by such customer, holds the same as a pledgee and on his bankruptcy the customer is entitled to the stock on payment of the amount due thereon, or to the surplus realized from its sale by the trustee, to the exclusion of the bankrupt's creditors," (namely marginal traders).

In re Bolling, 147 Fed., 786 Syl.;

Duel vs. *Hollins,* 241 U. S., 523 at 527.

In our case at bar none of the marginal traders did so pay for their stock (Record, page 7b). All of their stocks were sold in order to liquidate the indebtedness to the pledgee and the marginal stocks more than paid that debt: but if those marginal traders had wished to save themselves any loss they could have paid up the amount due on their purchase, demanded their stock and thus placed themselves in a preferred class the same as those who had paid for their stock in full before the bankruptcy. Thus those who had paid for their stock in full before bankruptcy as well as who had paid up afterwards in order to secure the stock, would be in the same preferred class and if the marginal stock did not pay the pledged indebtedness in full, these preferred holders must share pro rata such deficiencies in the amount of the pledged indebtedness as was not covered by the pure marginal stock.

This position is fully set forth *In re Wilson,* 252 Fed., 635-6, Rolph's claim. There the Class "A" creditors were those whose stock was fully paid for, and Class

"B" the pure marginal traders, exactly the position in the case at bar but with this difference; that in our instant case there is no deficiency to be shared by the preferred or Class "A" claimants. All the pledgee's debt was paid out of the marginal stock so there is no debt to be shared by the Midvale Steel and the other twenty paid-in-full stocks which survived the liquidation by the pledgee, while in the Rolph claim (Wilson case) there was not sufficient of the marginal stock when sold, to pay the pledge so that the Class "A" or preferred claimants had to share the deficiency and Rolph received his stock but had to pay in the value of his stock and share in the Class "A" claims in proportion to the amount he paid in and that the Class "B" lost their whole margin on which they were gambling for a rise in market, Class "A" sharing only what debt to pledgee was not paid by Class "B".

This same point was raised and similarly settled *In re Hollins*, 241 U. S., 523, where the court held that Duel and Weiners, marginal traders, who offered to pay up the balance due on their stock were entitled to do so and to claim the stock or their just proportion of that kind of stock which the bankrupt had on hand and that other marginal traders could do likewise, and that when they did so, they were preferred as to those stocks which they claimed and which were on hand, or to their proportion thereof if there was not sufficient for all paid-in-full claimants. And in that case too the stock was bought by the broker, issued in the name of the broker or the correspondent and not particularly assigned to the claimant exactly as in our case at bar.

Thus it is squarely held that where stock certificates

were delivered to a broker, as security for trades, but without authority to pledge and where there were no trade pending, but contrary thereto the stock was pledged by the broker; when the loan was liquidated and it was found unnecessary to sell the stock in order to satisfy the debt for which it was pledged, the customer could recover.

In re McIntyre, 181 Fed., 955, Pippy's claim at 958.

That being the rule where creditors delivered specific stock to the broker to handle as collateral, logic would hold the same rule in case the broker bought stock for the customer and it were sufficiently identified as is Steer's. The courts have so held in a case very similar to our claim of Steer, where the broker purchased stock through another firm, fully paid for by the customer, and the firm so purchasing retained the stock and later sold it to pay an indebtedness of the bankrupt broker to them, leaving a balance of cash in their hands. The court held that the claimant's money was in this balance, that as against the bankrupt and his general creditors whose rights were no greater, the presumption was that the proceeds of the customer's stock went into the same balance and he was entitled to recover the same; that the broker had no right to authorize his correspondent to sell this customer's paid-in-full stock in priority to his own (the broker's) stock, namely that purchased by him for his marginal customers. In our Steer claim as in the case under discussion no other customer of the broker was "long" on the stock claimed at the time of the failure except customers who paid a debit balance to the firm against the stock bought for them and thereby placed themselves in a preferred position as to those

stocks. The court ordered the proceeds of the sale of the Maxwell stock returned to him.

In re Graff, 117 Fed., 343, claim of Maxwell.

Judge Bledsoe in his opinion of March 14th in this case stated the correct rule, we believe, namely: that anyone "who bought on margin through Mason & Owen would not be entitled to have their losses shared in or contributed to by those who, like Steer, paid for their stock in its entirety." Subsequent to such decision the testimony of Will J. Thayer at that time trustee but now attorney for a new trustee, covering that point was received by the court and is summarized in the stipulation for record on appeal (Record, page 7b), showing that the whole loss could be and was absorbed by the marginal stocks.

IN RE APPELLANT'S CLAIMS

But notwithstanding this unbroken and conclusive line of bankruptcy cases, appellant claims that Steer ordered a purchase of stock for cash but that Mason & Owen made the purchase on margin hence Steer must either repudiate his contract and demand his money back, i. e., become a general creditor and take his loss with the marginal traders, or he must ratify and take his stock subject to the lien of Logan & Bryan and in that case also share the loss the same as the marginal traders. This cannot be justice nor is it the law, for Mason & Owen are presumed to have remitted the money paid by Steer, to their correspondent and to have kept 100 shares of Midvale stock on hand at all times for the customer.

Gorman vs. *Littlefield*, 229 U. S., 19 at 25.

Appellant also claims that the purchase of this stock

increased the indebtedness of the pledgee against all of the stock held by them but overlooks the fact that the Steer transaction not only increased the stock held as security but increased the cash on hand and unless Steer can now take out his stock or its purchase price the marginal traders will have benefited to the extent of the cash paid in by Steer in that transaction.

How then under general rules of equity could the marginal traders who have only partially paid for their stock and thereby made necessary, in the first place, the pledge, in order to carry their unpaid balance and who did not protect their account on bankruptcy by paying the amount due on their stock and thereby becoming preferred creditors—how should they in fairness and equity benefit in the transaction and take all or part of the stock from one who paid for his in full and the use of whose stock in the pledge, was a conversion at least, or probably a larceny.

In re McIntyre, supra, syl. 2;

Wahl vs. *Tracy,* 121 N. W., 660.

Counsel does *not quote a single bankruptcy case* contrary to our conclusion but relies on what he calls general principles, as in the case of *Wahl* vs. *Tracy,* 121 N. W., 660, *not a bankruptcy case* but one which discusses the relationship between a broker on an unexecuted order and the ordering creditor and decides rights of broker and purchaser, having no point as to relation of different classes of buyers and no bearing as to whether a paid-in-full stock claimant has a preference over one buying on margin and who is still indebted for his stock. Tho even in that case the court said that had the customers paid cash, the stock would have been his prop-

erty from the time of the purchase free from liability to the general creditors.

Again, no doubt the appellant's case of *National* vs. *Hibbs*, 229 U. S., 391, tho *not involving bankruptcy* or rights between customers, states a well recognized principle of equity; but when applied to cases of this kind the courts invariably have held that tho the stock owner did thereby expose himself to the risk of losing the stock which was pledged by the broker for broker's own debt, if the pledgee in good faith and for valuable consideration found it necessary to sell the stock in order to secure the payment of advances, on the doctrine of estoppel; but that the customer *did not by such transfer* part with his title to the stock in event the pledgee found it *unnecessary* to sell the stock in order to satisfy the debt for which it was pledged, and could recover the stock or if sold the proceeds thereof. Here the whole theory of estoppel claimed by appellant is considered and exploded as it relates to a bankruptcy case like ours.

In re McIntyre, 181 Fed., 955 at 958.

As appellant quotes, Mason & Owen owned outright all of the stocks purchased for marginal traders (until such purchasers paid for their stocks in full) but *did not own* and could not sell or rightfully pledge those paid for in full.

In re Wilson, 252 Fed., 631 at 649;

In re Graff, 117 Fed., 343 at 344.

Counsel also r fers to *Whitlock* vs. *Seaboard National Bank*, 60 N. Y. Supp., 611, a decision by a state court *not in bankruptcy* which attempts to settle rights between co-sufferers. Here we have none between co-sufferers since the Steer stock and all others in the same

class which were paid-in-full survived the liquidation and have no loss to share. On the other hand all the marginal traders are in the same boat, all their stock has been sold and none of them paid up their debit balance and claimed their stock. In that case there is no question raised as to who are preferred, all were in the same class.

The evidence in the case at bar shows that all moneys received by Mason & Owen were forwarded to their correspondents Logan & Bryan and the presumption must be that the balance of Steer's money was forwarded and augmented the amount of cash to their credit with Logan & Bryan and as Judge Bledsoe in his decision of February 1st, 1922, said, "it is to be presumed of course that Mason & Owen did the thing required of them, that is, paid this amount of money on account of the purchase price of the Steer stock rather than that they had embezled it, that is, used it for their own private speculation." (Record, page 14.)

There is no showing of the amount of indebtedness on March 20th, 1920, from Mason & Owen to Logan & Bryan nor the amount of the stocks pledged and in the hands of Logan & Bryan; there is no showing that there was any loss or insolvency at that time and there probably was none, and the sale of the stock then held by the pledgee would have paid out in full. It was only on the declining market of the Fall of 1920 that the fictitious named account in which the bankrupts purchased stock on their own account showed a loss.

The marginal traders paid Mason & Owen a 10% or other larger percentage on the purchase price of their stocks; the pledge of those stocks so purchased was nec-

essary in order to borrow the money to carry their unpaid balance. The bankrupts used the credit of these rightfully pledged stocks to speculate and just before bankruptcy their tradings showed an irretrievable loss. What dividends have been paid have to that extent reduced their percentage investment—but now their quondam Receiver—Trustee—attorney—appellant asks that Steer who paid 100% and needed no pledge or loan to carry his stock, should pay more and give it to further reduce the losses of the marginal traders who were gambling for a rise in market. We need no hypothetical case to show the equities of the parties.

We submit that under the facts and the law the 100 shares of Midvale stock is sufficiently identified; there is no one else claiming this stock, no one else bought this character of stock, it is on hand for us. We further submit that the cases we have cited fully cover the whole subject, are exclusively bankruptcy cases, are absolutely conclusive, all to one end, namely that Steer is entitled to his stock or if sold to its value.

AS TO FRIVOLOUS APPEAL.

We also submit that the argument of appellant is so apparently fallacious, intentionally false and misleading, the cases cited are not in bankruptcy, but are so palpably inapplicable and inconclusive and the premises so unfair, inequitable, and absolutely unsupported by the law, that this court must needs draw the same conclusion that we have come to during this continued litigation and which we now urge, namely; that this appeal is taken frivilously and for ulterior purposes of the trustee or his attorney, which we could name if not for our hesitancy to go outside of the record—purposes other than a right

ful determination of these issues which have been by the courts often and clearly determined in the same view as we are now asking that they be determined.

We submit that this appeal is an unjust burden on appellee, Steer, not only by keeping him out of the use of his stock but by putting him to great expense and litigation to procure his patently rightful property.

Finally we submit then that the order of Judge Bledsoe for the delivery to us of the stock and of the accrued dividends should be affirmed.

Respectfully submitted,

GEORGE H. STONE,

Attorney for Appellee.